GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:2045
ANSWERED ON:12.12.2008
REMOVAL OF RESTRICTION ON INVESTMENT THROUGH PARTICIPATORY NOTES ROUTE
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Will the Minister of FINANCE be pleased to state:

(a) whether the Reserve Bank of India (RBI) has been advocating a ban on investment through ParticipatoryNotes (PN) in view of the opaque nature of the instrument which makes it difficult to assess the quality of funds;

(b) if so,reaction of the Government thereto;

(c) whether the Government has taken any decision to remove all the earlier restrictions on investment through PN by foreign investors;and

(d) if so, the details thereof?

Answer

MINISTER OF THE STATE IN THE MINISTRY OF FINANCE (SHRI PAWAN KUMAR BANSAL)

(a) and (b): Yes Sir.Reserve Bank of India is of the opinion that Overseas Derivative Instruments (ODIs)/ Participatory Notes (PNs) should not be permitted and accordingly it has suggested that no fresh issuance of PNs be allowed. However, the Expert Group headed by Dr.Ashok Lahiri,constituted by the Government of India,on "Encouraging FII Flows and Checking the Vulnerability of Capital Markets to Speculative Flows" examined the issue of PNs and recommended that the current dispensation for PNs may continue. Government's views are that PNs are market instruments that are created and traded overseas.Hence,Indian regulators cannot ban or control the issue of PNs;they can only be regulated, and they are indeed being regulated by SEBI.

(c) and (d): SEBI had imposed certain restrictions on Overseas Derivative Instruments (ODIs) in October 25,2007 which were to be subsequently reviewed. These restrictions were as follows:

1. FIIs and their sub-accounts not to issue/renew ODIs with underlying as derivatives.The existing positions to be wound down over 18 months

2. Sub-accounts of FIIs not to issue any PNs/ ODIs.The existing positions to be wound down over 18 months

3. The FIIs who were issuing ODIs with notional value of PNs outstanding (excluding derivatives) as a percentage of their AUC in India of less than 40% shall be allowed to issue further ODIs only at the incremental rate of 5% of their AUC in India.

4. Those FIIs with notional value of PNs outstanding (excluding derivatives) as a percentage of their AUC in India of more than 40% shall issue PNs only against cancellation/ redemption/ closing out of the existing PNs of at least equivalent amount.

These restrictions imposed were reviewed on 06,October 2008 and it was decided to do away with the quantitative restrictions applicable on the ODI positions that the FIIs could take with respect to their assets held in Indian securities. Further it was also decided to do away with the restriction imposed on the ODI issuances on derivatives. However,the requirement to issue ODIs to only regulated entities subject to KYC norms continues as before.